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NOTES

VALUE AND NOTICE IN THE NEW YORK INTERPRETATION OF THE NEGOTIABLE INSTRUMENTS LAW.—In the case of *Kelso and Company* v. *Ellis* (1918) 224 N. Y. 528, 121 N. E. 364, recently decided by the Court of Appeals of New York, two interesting points are brought out; the one, as to the status of a past debt as consideration for a negotiable instrument; the other, as to what constitutes notice of a defense beween the original parties such as to prevent a taker from being a holder in good faith.

As a result of the decision in *Coddington* v. *Bay*[1] and the *dictum* in *Swift* v. *Tyson*,[2] there has been a conflict between the state and federal courts in New York as to what constitutes "value" in negotiable instruments. The New York courts adopted the rule that a bill or note taken as collateral security for, or in conditional payment of, a past or pre-existing debt, was not taken for "value" so as to cut off equities existing between the original parties. The past debt in order to be sufficient consideration must be absolutely extinguished by the receipt of the note.[3] The federal courts, on the other hand, refused to follow state decisions on a question of general commercial law and have adhered to a view diametrically opposed to what has come to be known as the "New York rule." This divergence remained unchallenged until the passage of the Negotiable Instruments Law[4] which was intended by its sponsors to unify the law of negotiable instruments throughout the country.[5]

Of the states which adopted it after having committed themselves to the "New York rule," Iowa,[6] Kentucky,[7] Michigan,[8] Missouri[9] and North Carolina[10] have judicially declared the old rule to have been

[1] (1822) 20 Johns. *637.

[2] (1842) 41 U. S. 1.

[3] Mayer *et al. v.* Heidelbach *et al.* (1890) 123 N. Y. 332, 25 N. E. 416. There is one exception in that an accommodation note with no restriction placed upon its use will be good in the hands of a holder to whom it has been transferred either as conditional payment or collateral security for a past debt. Lehrenkrauss *v.* Bonnell (1910) 199 N. Y. 240, 92 N. E. 637; Grocers' Bank *v.* Penfield (1877) 69 N. Y., 502; Maurice *v.* Fowler (1912) 78 Misc. 357, 138 N. Y. Supp. 425.

[4] N. Y. Consol. Laws (1909) c. 38, § 51, "Value is any consideration sufficient to support a simple contract. An antecedent or pre-existing debt constitutes value; and is deemed such whether the instrument is payable on demand or at a future time." (Former Negotiable Instruments Law, 1897, c. 612, § 51.) § 53, "Where the holder has a lien on the instrument, arising either from contract or by implication of law, he is deemed a holder for value to the extent of his lien." (Former Negotiable Instruments Law, 1897, c. 612, § 53, as amended by L. 1898, c. 336.)

[5] Crawford, Negotiable Instruments Law (4th ed.) 3.

[6] State Bank *v.* Bilstad (1912) 162 Iowa 433, 136 N. W. 204, 144 N. W. 363; see Voss *v.* Chamberlain (1908) 139 Iowa 569, 117 N. W. 269. Before Negotiable Instruments Law: see Cable *v.* Buchanan (1899) 109 Iowa 66, 80 N. W. 1066.

[7] Campbell *v.* Fourth Nat'l. Bank of Cincinnati (1910) 137 Ky. 555, 126 S. W. 114; Wilkins *v.* Usher (1906) 123 Ky. 696, 97 S. W. 37. Before Negotiable Instruments Law: Alexander & Co. *v.* Springfield Bank (1859) 59 Ky. 534.

[8] Graham *v.* Smith (1908) 155 Mich., 65, 118 N. W. 726. Before Negotiable Instruments Law: Maynard *v.* Davis (1901) 127 Mich. 571, 86 N. W. 1051.

[9] Bank *v.* Morris (1911) 156 Mo. App. 43, 13 S. W. 1008; *cf.* Johnson *v.* Grayson (1910) 230 Mo. 380, 130 S. W. 673, decided after but arising before the Negotiable Instruments Law.

[10] Smathers *v.* Hotel Co. (1913) 162 N. C. 346, 78 S. E. 224. Before Negotiable Instruments Law: Brooks *v.* Sullivan (1901) 129 N. C. 190, 39 S. E. 822.

changed; Alabama[11] and North Dakota[12] have held in favor of the old rule without mentioning the Negotiable Instruments Law; while in New Hampshire and Ohio there are apparently no decisions on the point since the passage of the statute.[13] In Florida[14] and Virginia[15] the question did not arise until after the passage of the law, but thereafter the courts of these states held that a pre-existing debt did constitute value whether the bill had been given as payment or as collateral security. The Wisconsin statute,[16] adopting the Negotiable Instruments Law but specifically providing that a past debt would not in itself constitute value, was amended to conform to the Uniform Negotiable Instruments Law in 1917, since which time no cases have arisen.[17] In the majority of these states, it will, therefore, be seen that the Negotiable Instruments Law was accepted as constituting a past debt value whether taken as conditional payment or collateral security. The same result was expected in New York, but curiously enough, though the first decision held the law changed,[18] other decisions in the lower courts regarded the New York rule as unaltered.[19] These cases went on the ground that the Negotiable Instruments Law was not a departure from, but merely a codification of, the existing law which had always recognized that an extension, *i. e.*, an express agreement to forbear or "the actual payment and discharge of a pre-existing debt constituted the same a valuable consid-

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[11] Hawkins *v.* Damson & Abraham (1913) 182 Ala. 83, 62 So. 15; Miller *v.* Johnson (1914) 189 Ala. 354, 66 So. 486. The former case arose before the adoption of the statute.

[12] Porter *v.* Andrus (1901) 10 N. D. 558, 88 N. W. 567. This case arose before the adoption of the statute.

[13] The Uniform Negotiable Instruments Law was adopted in New Hampshire in 1909. Pub. Stat. Supp. 1913, 463; and by Ohio in 1902, Gen. Code (1910) § 8106 *et seq.*

[14] Crystal Riv. Lumber Co. *v.* Consolidated N. S. Co. (1912) 63 Fla. 119, 58 So. 129.

[15] Payne *v.* Zell (1900) 98 Va. 294, 36 S. E. 379.

[16] Laws of Wis. (1899) § 1675-51. "Value is any consideration sufficient to support a simple contract. An antecedent or pre-existing debt, discharged, extinguished or extended, constitutes value; and is deemed such whether the instrument is payable on demand or at a future time. But the indorsement or delivery of negotiable paper as collateral security for a pre-existing debt, without other consideration, and not in pursuance of an agreement at the time of delivery, by the maker, does not constitute value."

[17] Laws, 1917, c. 179, § 2; Wis. Stat. (1917) § 1675-51.

[18] Brewster *v.* Shrader (1899) 26 Misc. 480, 57 N. Y. Supp. 606.

[19] Carpenter *v.* Hoadley (1910) 138 App. Div. 190, 123 N. Y. Supp. 61, aff'd. without decision in (1911) 203 N. Y. 571, 96 N. E. 1111. "This statute, (§ 51) however, must be construed to mean that, in order to constitute value which wil support an action against an accommodation maker of a check which has been fraudulently diverted, the antecedent debt must have been cancelled and discharged on the acceptance of the check or the time of payment extended." Harris v. Fowler (1908) 59 Misc. 523, 525, 110 N. Y. Supp. 987; Roseman *v.* Mahony (1903) 86 App. Div. 377, 83 N. Y. Supp. 749.

eration for the transfer of commercial paper and shut off prior equities existing against it."[20]

Such being the situation, the Court of Appeals in *Kelso and Company* v. *Ellis, supra,* held that "the Negotiable Instruments Law (§ 51) provides that 'an antecedent or pre-existing debt constitutes value' and thus brings the law of this state into harmony with that of the United States Supreme Court * * * it is perfectly clear that for the sake of uniformity New York has abrogated the rule which has been in force since the year 1822." The plaintiff had given the payee credit for the note "as cash" on his general account and it might seem that this was on absolute payment and that the instant question, whether the old rule has been changed, was not raised. But in view of the fact that "the indorsee of a bill or note of a third party, who takes it on account of a precedent debt, takes it by implication as conditional payment;"[21] and that the New York courts have required a strict compliance with the rule of absolute payment and extinguishment,[22] the present case appears to be one of conditional payment. At any rate, there is no trace of collateral security, thus leaving that part of the question unsettled. In several of the lower courts, the same view as that expressed by the Court of Appeals has been taken. Thus, in *King* v. *Bowling Green Trust Company,*[23] the court said: "While no case in this state on the point has been called to our attention, it seems plain that those sections were intended to bring the law of this state into harmony with that of the other States and of the Federal courts." Here, however, the plaintiff bank had credited the amount of the note to the account of the transferor and, as in the principal case, the matter of transfer for security was not before the court. With the exception of one case in Special Term,[24] statements to the same effect in other decisions are irrelevant as regards this point.[25]

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[20] Sutherland *v.* Mead (1903) 80 App. Div. 103, 107, 80 N. Y. Supp. 504.

[21] Daniel, Negotiable Instruments (6th ed.) § 830.

[22] Phoenix Ins. Co. *v.* Church (1880) 81 N. Y. 218.

[23] (1911) 145 App. Div. 398, 402, 129 N. Y. Supp. 977.

[24] Brewster *v.* Shrader, *supra,* footnote 17.

[25] The court in Brown *v.* Brown (1915) 91 Misc. 220, 154 N. Y. Supp. 1098, evidently believed that a pre-existing debt would support a note given as collateral security, but this is apparently *dictum* as the court said that the defendant's claim that the note was given as such was not a fair inference from the evidence. In Broderick & Bascom Rope Co. *v.* McGrath (1913) 81 Misc. 199, 142 N. Y. Supp. 497, the transferee had accepted the note in payment of a pre-existing debt. It was said in Milius *v.* Kaufmann (1905) 104 App. Div. 442, 444, 93 N. Y. Supp. 669, that, "the plaintiff having taken it as security for an antecedent debt is regarded as a holder for value." But in view of the facts of the case, this statement was uncalled for. Petrie *v.* Miller (1901) 57 App. Div. 17, 67 N. Y. Supp. 1042, held that as the plaintiff had taken the note either as a discharge of the debt or as collateral security, he was a holder for value. But it also appeared that there was a good cause of action between the original parties.

The difference between conditional payment and collateral security, though slight, leaves open to the courts of New York the possibility of still following their opinions relative to a note as collateral security for a past debt, as expressed before the Negotiable Instruments Law and as indicated in the lower courts after it, or of accepting the intentions of the draftsmen and the construction of other courts, that the statute has gone the whole way in unifying the law of negotiable instruments. This is not only the more desirable, but, it would seem, the sounder view. There can be little doubt that a statute aimed at unifying the law would not have overlooked this, the most glaring divergence of all. Although the federal courts have never followed the state in their interpretation of the law on this point, and for that reason their opinion can be of little weight, they have not hesitated in declaring that the New York rule had been changed, and the strong language of the Court of Appeals clearly foreshadows its adherence in the future to the same sensible view.[26]

Turning to the question of notice, it appeared that from previous dealing with the payee, the indorsee, the plaintiff, must have known that a substantial part of the consideration for the notes was the delivery of a piano which the payee, Howard, had ordered of him and which he had refused to deliver because Howard's credit was no longer good. The plaintiff had been in the habit of furnishing Howard pianos and receiving notes of third parties which he knew had been given for contracts, the main consideration for which in each case was the delivery of a piano. The notes in question were dated October 24, maturing two, three, four, five, six and seven months after date, a letter of December 3 directed the plaintiff to deliver a piano to the defendants at once, while the delivery of the notes to the plaintiff was on December 22. In view of these facts the case was sent back for a new trial, it being held that the circumstances would "sustain a finding that 'by the simple test of honesty and good faith' * * * it became the duty of plaintiff to inquire as to the real situation between Howard and the defendants."

In order to subject the transferee for value of a note to the infirmities existing between the original parties, it must be shown that he took the note with notice of the infirmity or with actual bad faith. Notice may be either actual notice of the existing circumstances or it may be conclusively presumed from certain facts which within certain standardized limits the courts have held to constitute constructive notice. This view existed previous to the Negotiable Instruments Law and § 56 of that statute has been construed not to change the law in this regard.[27] To prevent recovery in the instant case it must fall within one of these classifications.

It is now generally accepted that mere knowledge that a note has been given as the consideration for an executory contract is not such

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[26] *In re* Hopper-Morgan Co. (D. C. 1907) 154 Fed. 249.

[27] Norton, Bills & Notes (4th ed.) 432n.

a standardized inference as will constitute constructive notice,[28] as the presumption is that the contract will be carried out.[29] Of course, if the purchaser knows at the time of taking that the promise forming the consideration has been broken, he cannot recover.[30] As to what short of actual knowledge of breach will constitute such bad faith as to prevent the taker from being a holder in due course is a more difficult question. It has been generally laid down that "The circumstances of the transaction may be of such a character as to intimate strongly a defect in the title, and if they are such as to invite inquiry they will suffice, provided the jury think that abstinence from inquiry arose from a belief or suspicion that inquiry would disclose a vice in the paper."[31] So buying commercial paper from a corporation after handling thousands of dollars' worth of it and knowing of trouble in collections will constitute bad faith to subject the taker of the note to any fraud in the contract which caused its inception.[32] And where the taker knows that the notes were given in consideration of a contract for the sale of wheat or oats and should know from every day accounts in the newspapers that such contracts were parts of a confidence game, this knowledge in connection with other suspicious circumstances will sustain a finding of bad faith.[33]

However, knowledge that the contract is likely to be broken will not in itself impute bad faith.[34] Nor will mere suspicion of breach be sufficient to constitute a defense.[35] "Suspicious circumstances to be sufficient to require investigation, must be of a substantial character, and so strong that bad faith on the part of the indorsee in failing to make such investigation may be reasonably inferred."[36] So where the vendee of a note knew that the seller engaged in gambling contracts and suspected that the note was given for such a contract, it was held that these facts did not prevent his becoming a bona fide purchaser in the regular course.[37] Similarly, knowledge that a note previously obtained from the same payee was fraudulent,[38] or that

[28] Producers' Nat'l. Bank *v.* Elrod (Okla. 1918) 173 Pac. 659; Tradesmen's Nat'l. Bank *v.* Curtis (1901) 167 N. Y. 194, 60 N. E. 429; Davis *v.* McCready (1858) 17 N. Y. 230; *contra,* Sumter County State Bank *v.* Hays (1914) 68 Fla. 473, 67 So. 109.

[29] See Siegel *et al. v.* Chicago Trust & Savings Bank (1890) 131 Ill. 569, 574, 23 N. E. 417.

[30] Bryant *v.* Sears *et al.* (1855) 16 Ill. 288. The payee must, of course, have this notice at the time of taking. Mt. Vernon Nat'l. Bank *v.* Kelling-Karel Co. (1914) 189 Ill. App. 375.

[31] Daniel, *op. cit.* § 795b.

[32] Stevens *v.* Venema (Mich. 1918) 168 N. W. 531.

[33] Goodrich *v.* McDonald (1889) 77 Mich. 486, 43 N. W. 1019.

[34] Piedmont Carolina Ry. *v.* Shaw (C. C. 1915) 223 Fed. 973.

[35] First Nat'l. Bank *v.* Moore (C. C. 1906) 148 Fed. 953; *cf.* Capital Savings Bank & Trust Co. *v.* Montpelier Savings Bank & Trust Co. (1905) 77 Vt. 189, 59 Atl. 827.

[36] Batesville Bank *v.* Lehner (1909) 43 Ind. App. 457, 462, 87 N. E. 990.

[37] Mitchell *v.* Catchings (C. C. 1885) 23 Fed. 710; *cf.* Merchants' Nat'l. Bank *v.* Sullivan (1896) 63 Minn. 468, 65 N. W. 924.

[38] Rice *v.* Barrington (1908) 75 N. J. L. 806, 70 Atl. 169.

the business of the payee was dishonorable and of such a nature as to put a prudent man on inquiry,[39] was held insufficient to defeat the rights of a purchaser for value. And, of course, where any investigation on the part of the taker would prove futile, he is protected.[40]

However, this suspicion may become of such a nature as to charge the taker with bad faith, and thus render him liable to the equities between the original parties. Where an indorsee knew that the title to land given for a note was questionable and that the grantee intended to resist the collection of the note if evicted,[41] or where the taker's suspicion was so keen as to require a new note to be made before taking,[42] the circumstances are clearly such as to put him on inquiry. From this it might well be left to the jury to decide whether any bad faith existed in the principal case.

SHOULD A STRIKE EXCUSE DELAY IN PERFORMANCE OF A CONTRACT?—The courts have long recognized that under certain circumstances subsequently arising contingencies, unforseen at the time of the inception of a contract, will excuse impossibility of performance.[1] Should a supervening strike be regarded as such a contingency? The courts have generally held that where a contract specifies a fixed time for performance and there is no stipulation as to the effect of a subsequent strike, the party unable to perform in due time because of the strike is not excused from his obligation and is bound to pay damages for non-performance.[2] The other party is not obliged to accept performance after the date fixed.[3] If he does so he is entitled to damages for the delay.[4] This result apparently follows from the recognition by the courts that a strike, just as numerous other contingencies, is one of the risks that is incident to the obligation and that the party assum-

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[39] Shreeves *v.* Allen (1875) 79 Ill. 553.

[40] Morehead *et al. v.* Harris (1916) 121 Ark. 634, 182 S. W. 521.

[41] Knapp *v.* Lee (1826) 20 Mass. 452.

[42] Pierce *et al. v.* Kibbee (1879) 51 Vt. 559.

[1] Pollock, Contracts (Wald, 3rd ed.) *398 *et seq.;* 2 Parsons, Contracts (9th ed.) *673; Woodward, "Impossibility of Performance, as an Excuse for Breach of Contract." 1 Columbia Law Rev. 529; McNair, "War-Time Impossibility of Performance of Contract." 35 Law Quart. Rev. 84; 16 Columbia Law Rev. 668.

[2] Morse Dry Dock & Repair Co. *v* .Seaboard Transportation Co. (D. C. 1907) 154 Fed. 90; Koski *v.* Finder (1913) 176 Ill. App. 284; Budgett & Co. *v.* Binnington & Co. [1891] 1 Q. B. 35; see Barry *v.* United States (1912) 229 U. S. 47, 33 Sup. Ct. 681.

[3] See Grannis & Hurd Lumber Co. *v.* Deeves (N. Y. 1893) 72 Hun 171, 25 N. Y. Supp. 375; Anson, Contracts (12th Eng. ed.) 298. For a discussion of the effect of stipulations as to time in courts of equity see Anson, *ibid.;* Pollock, *op. cit.* *504.

[4] In Koski *v.* Finder, *supra,* footnote 2, a building contractor who because of a two months' strike had not completed his contract at the date of performance was not allowed to sue on his contract for the work he had done. Although he was permitted to proceed on a *quantum meruit,* the defendant was allowed to counterclaim for the damage he had sustained as the result of the delay.